Public Interest Companies and the four principles of public service reform

A paper for the Office of Public Service Reform

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13 February 2003

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1. Introduction

Improving the quality of public services is the key priority for the second term of the Labour government. Ensuring the appropriate level of funding is central to any improvement, and the Spending Reviews have committed substantial funds to 2005-06. The Government has, however, emphasised that public service reform needs to accompany any increase in public funds.

The Labour Government has certainly not lacked a passion for structural reform. However, it has struggled to provide a coherent intellectual case for the principles underlying reform. To co-ordinate policies and help disseminate the Government’s reforming agenda, the Prime Minister set out four principles of public sector reform in the Government paper ‘Principles into Practice’, published March 2002. These four principles offer a useful insight into the Government’s priorities.

Questions remain about how these principles will be applied in practice. In part, the Government’s reform agenda is linked to the type of organisation that delivers public services. This has been seen most clearly in the fierce debates about the extent to which the private sector should be involved in the delivery of public sector construction projects via the PFI. The ippr has and continues to be at the forefront of that debate.

Over the last year the debate about the best way to deliver public services has stumbled on a new option – a not-for-profit company, or ‘public interest company’ (PICs). From Network Rail, National Air Traffic Services and Foundation Hospitals, there has been much political and media attention towards these ‘new’ organisational forms. In addition, at a local level and out of the media spotlight others have been experimenting with Public Interest Companies; from the LEA in Hackney, leisure services in various local authorities, and in the new charity-friendly procurement regime in the London Borough of Tower Hamlets.

Despite this recent interest, to date there has been no authoritative investigation into what these hybrid organisations are and why or when they are considered favourable to public or private sector alternatives. There has certainly been no work on whether PICs can help achieve the Prime Minister’s four principles of reform.

ippr will publish a hard-headed report into the potential of public interest companies in April 2003. This report will consider PICs in the context of the Government’s public service reform agenda, identifying policy areas where they might be the most appropriate method of delivery.

ippr are critical friends of Public Interest Companies, not evangelists on their behalf. In our view PICs can achieve some of the important principles of reform set out by the Government, but only in certain restricted circumstances. Whilst we believe Government should give serious consideration to using PICs alongside other methods of delivery, Government should remain cautious. PICs need to avoid becoming the next policy ‘fad’ and must avoid being used for inappropriate reasons.
**Definition of PICs**

ippr has defined a Public Interest Company as an organisation that:

- does not usually have shareholders (where they do have shareholders they are restricted in their ability to profit from the organisation, or they have another key interest in the organisation besides profit)
- is to some degree independent from the state
- delivers a public service

It is helpful to consider Public Interest Companies as a type of Public Private Partnership (PPP). It is also useful to place PICs in the context of other organisational forms available to public managers. These encompass full public sector control, through to complete privatisation. This could be expressed in a simplified manner through two ‘public service continua’ shown in box 1.

**Box 1: The general public services continuum**

<table>
<thead>
<tr>
<th>State provided services</th>
<th>Public Interest Companies</th>
<th>Joint ventures</th>
<th>Private services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quangos</td>
<td>Contracts with PICs</td>
<td>Contracts with for-profit companies</td>
<td>(Private sector)</td>
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<tr>
<td>(Public sector)</td>
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It is important to make the distinction between two types of public services; the revenue generating public enterprises (including the privatised utilities and most public transport services) and the more general tax-funded public services (core state services such as the majority of services provided by the NHS, and schooling up to the age of 18). User charges and what are often monopoly essential services make discussions about PICs and public enterprises different from those of the general public services. This paper will focus on the general public services and leave discussions about the public enterprises to ippr's forthcoming publication on PICs.

**PICs consist of a multiplicity of organisational forms**

Despite the recent interest, the concept of the Public Interest Company is not a new one. Housing associations have delivered social housing for over a century using the same basic model. Nor is there one simple model of a Public Interest Company; one of the sectors strengths is the variety of organisational forms that can be employed.

Some of the key types of Public Interest Company are listed below:

<table>
<thead>
<tr>
<th>Type of PIC</th>
<th>Key features</th>
<th>Examples</th>
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<tbody>
<tr>
<td>Company limited by Guarantee</td>
<td>Management answer to appointed ‘members’ who carry out the same role as shareholders, but who cannot profit from the company.</td>
<td>This is the most popular form of PIC. Examples range in size from small Development Trusts to large utilities such as Network Rail.</td>
</tr>
<tr>
<td>Industrial and Provident Society</td>
<td>There are two types of Industrial and Provident Society; the bone-fide mutual, owned by its members for its members, and examples include organisations set up to run ex-local authority leisure services in Bristol and</td>
<td></td>
</tr>
<tr>
<td><strong>Public or Private Limited Company owned by users of a service</strong></td>
<td>If a limited company or a PLC is owned by the users of the service then the owners have a different relationship to the company from typical shareholders.</td>
<td>An example is the joint venture PPP for National Air Traffic Services (NATS) which is owned by the Government, staff, and a consortia of airline companies who have a controlling stake.</td>
</tr>
<tr>
<td><strong>Public or Private Limited Company wholly owned by Government</strong></td>
<td>In some circumstances the Government may wish to provide public enterprises with the freedoms of a typical company, but for public interest reasons may want to retain all shares and control.</td>
<td>Examples include the Post Office and British Nuclear Fuels Ltd.</td>
</tr>
<tr>
<td><strong>Share trust</strong></td>
<td>PICS can be organised as private limited companies with nominal share capital held in trust. The holding company owns 100% of the operating company, which in turn is operated as a PLC. The trust is established in favour of a not-for-profit or charitable purpose, and independent trustees are obliged to act in accordance with these instructions.</td>
<td>An example is Education Capital Finance, the funding intermediary for the Further Education sector.</td>
</tr>
<tr>
<td><strong>Trusts and special organisations</strong></td>
<td>There are a number of bodies that do not use existing company models, but which have specially created bodies that conform to PIC definitions.</td>
<td>Examples include the Trust Ports, Higher Education Corporations (the majority of Universities set up after 1992), and the older universities set up under Royal Charter or under their own Acts of Parliament as Chartered Corporations.</td>
</tr>
<tr>
<td><strong>Charity</strong></td>
<td>Charitable status is not in itself a form of incorporation; it is granted in addition to an organisation’s basic legal status. Charities are usually organised as either companies, trusts, or they are unincorporated or ‘exempt’ (ie incorporated as Industrial and Provident Societies, by Royal Charter, or otherwise by statute).</td>
<td>Organisations which are well known for being charities (such as Help the Aged, or the Children’s Society deliver many public services, especially in areas such as personal social services, hospice care and home / school links.</td>
</tr>
<tr>
<td><strong>‘Community Interest Company’ (proposed)</strong></td>
<td>The Prime Minister’s strategy unit has proposed this new legal form for public interest Companies. It is designed to alleviate the potential danger of demutualisation and improve the ‘brand’ of PICs. It might also specify a certain level of public involvement in governance and subject organisations to a public benefit test.</td>
<td>Whilst action on the demutualisation issue is welcome, it is not clear if a new type of PIC is the best option. Community Interest Companies are unlikely to become the sole way of organising PICs and may lead to more, not less confusion. Also, specifying public involvement and regulated where it can be used might reduce the attractiveness of the new form relative to alternatives.</td>
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The four principles of reform and PICs
The Prime Minister set out his four principles of public service reform in the Office for Public Service Reform document ‘Reforming our public services: principles into practice’ March 2002. The principles are:

- **National standards**: Providing national standards that really matter to the public, within a framework of clear accountability, designed to ensure that citizens have the right to high quality services wherever they live.

- **Devolution**: These standards can only be delivered effectively by devolution and delegation to the front line, giving local leaders responsibility and accountability for delivery, and the opportunity to design and develop services around the needs of local people.

- **Flexibility in delivery**: More flexibility is required for public service organisations and their staff to achieve the diversity of service provision needed to respond to the wide range of customer aspirations. This means challenging restrictive practices and reducing red tape; greater and more flexible incentives and rewards for good performance; strong leadership and management; and high quality training and development.

- **Expanding choice and contestability**: Public services need to offer expanding choice for the customer. Giving people a choice about the service they can have and who provides it helps ensure that services are designed around their customers. An element of contestability between alternative suppliers can also drive up standards and empower customers locked into poor service from their traditional supplier.

The use of Public Interest Companies, like many other aspects public service reform, could be associated with each of these principles. However, there are three inter-linked potential advantages of PICs that relate closely to the spirit and the detail of these principles of reform. They are:

- Providing for contestability in the delivery of key public services
- Providing for clarity over management responsibilities and flexibility in how services are managed
- Providing for accountability and devolution of organisational governance to local communities

This paper will take each of these potential advantages in turn.

2. Contestability

*Contestability* is the principle whereby new providers of services can be brought in to replace those who are not performing adequately. This acts as a continual incentive for providers to consider how they can improve their service. Contestability differs from the forced use of competition within public services in that there is no regular market testing. Instead, it provides a latent but real option that public managers can choose alternative providers if service quality slips. It should be determined by public managers on the ground, not in accordance with a rigid formula.

The principle of contestability can be applied within a publicly provided system (eg Fresh Start schools, where the management of a successful state schools takes over the management of a failing school). However, IPPR has argued that to date the public sector has suffered from too limited a pool of providers; too little *diversity* of provision.
Public private partnerships can help provide this greater diversity and contestability. ippr has made reference to PFI prisons to demonstrate how these effects can be realised. New PFI prisons give the private sector responsibility for not only building and maintainance, but also for running the prison on a day to day basis. This has broken the previous public sector monopoly in the prison service, which was criticised for its poor management and sometimes brutal regimes. There is evidence to suggest that this new contestability in the prison service gave public sector prison service managers incentives to improve their effectiveness. Indeed, in-house teams won back the management of Manchester and Blakenhurst prisons, which were previously contracted out.

However, the opportunities for greater diversity in the delivery of public services are limited. In both the NHS and education most PFI deals only include ancillary staff (for example cleaning and maintenance), with core services (teaching and nursing) being continued to be provided by the public sector. Prisons, in fact, are a notable exception from this pattern. The reasons for this are in part political and part practical, although it could be argued that political hostility to the wholesale expansion of contracted out complex public services is based on sound policy principles.

Incomplete contracts

In public private partnerships such as the PFI the contract between the public sector and private provider is the means by which the public interest is protected. For relatively simple public services that might be delivered through the PFI, such as new roads, it is relatively easy to specify all the important elements needed in a contract. If aspects of the contracts are unclear or if important elements have been left out, then the only downside is likely to be the cost of resolving the issue or renegotiating contracts. But for more complex projects decisions about what is and what is not included in a contract are critical. In mainstream public services, such as large NHS hospitals, there are an infinite number of small incidents that take place between staff and the public which take time and money, but which would not be considered priority outcomes or outputs. Such factors would be difficult to contract for, yet they are essential parts of these services. If a contract does not provide everything expected by the public sector, vital public interest issues will be at stake, not just costs considerations.

PICs offer an opportunity to provide a public sector safeguard when contracting for complex and vital public services. Because a range of stakeholders are in charge of corporate governance in the place of shareholders, PICs might be expected to behave differently from for-profit companies in a similar position. The profit maximising incentive of shareholders is diluted by the motives of other stakeholders, which may reduce the danger of incomplete contracts leading to the neglect of important social considerations.

PICs are only one way to delivery diversity and contestability

Public Interest Companies offer an acceptable and logical way in which diversity and contestability can be safely injected into our key public services. However, PICs are not the only way to bring in greater diversity. There may be substantial political barriers to increasing the use of private sector provision in core public services, but the example of PFI prisons shows that this is not an option that should be dismissed out of hand.

There is much less political opposition to private sector provision in prisons than in health and education; prisoners are understandably low on the public’s sympathy list. Yet PFI prisons have helped deliver high quality prison regimes and incomplete contracts do not appear to have caused significant problems. This might be because prisons started from an unusually low quality threshold, but it is important to realise that a particular organisational form does not have to be 100 per cent theoretically perfectly suited to its application in order to improve services through contestability.
It is also worth noting that only a small degree of contestability is potentially required before service quality can improve throughout the whole sector; by 1998/9 only 10 per cent of prison provisions was delivered by the private sector, yet by that time the prison sector was a truly contestable system. As such, it makes sense for Government to use a degree of for-profit provision alongside public provision and Public Interest Company provision in public services; a move being pioneered by government in the use of for-profit Diagnostic and Treatment Centres in the NHS which will carry out routine operations that are easier to contract for than complex acute hospital services.

3. Clarity over management roles

Contracting for public services in itself could help achieve public service reform as set down by the Prime Minister. It could cut across the principles of national standards, devolution and of flexibility in delivery.

One of the main benefits of Public Interest Companies arises from a desire to provide public managers with clarity about what is expected of them, and to give them the freedoms they need to achieve those ends. Currently, many public sector managers, particularly those operating in the mainstream public services controlled from Whitehall have little clarity about their responsibilities. Civil servants in Whitehall know that they will be heavily criticised by their managers, by the Public Accounts Committee, by the National Audit Office, or by the media if the decisions they take have negative results. However, they also know that if those decisions result in success they will not be rewarded. There is little devolution of power to front-line operatives and too often a culture of risk aversion dominates.

Indeed, this is one of the clear benefits of the purchaser / provider split seen in the PFI approach to infrastructure projects. Previously, public sector managers were too focussed on inputs, such as the numbers of people who should be employed in projects, rather than outcomes and outputs from the service. The previous procurement regime also placed too little emphasis on the costs of altering the terms of contracts once the scheme was up and running, and it was poor at identifying risks in a project and ensuring that they are borne by the party best able to manage them.

As discussed in the previous section contracting to for-profit companies using a PFI approach might not be optimal for complex public services, but these benefits could be achieved by contracting to a Public Interest Company.

PICs might also be justified on the basis that they devolve power and responsibilities. Government is not only becoming aware that it provides little clarity in management roles, but that the ‘command and control’ model of public service delivery, whereby Whitehall effectively takes both management decisions and runs services direct, is being considered increasingly ineffective. There is precious little devolution of power to the front line or the local level in too many public services; a fact acknowledged by the Chancellor of the Exchequer1.

PICs can help this situation by providing a way in which complex public services can safely be delivered by devolved quasi-private sector organisations. But they can also help by allowing local organisations to set their own priorities, rather than just implementing a set of centrally imposed policy decisions. An example is the way in which service commissioning PICs could maintain a balance between the needs of central government, local government and the local community. Although the idea is still in

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1 in a speech to the SMF at the Cass Business School, 3rd February, 2003
development. Primary Care Trusts organised as PICs or ‘foundations’ could be seen in this way. Another example is where the PIC is both service deliverer and has some control over its own priorities which are in part dictated by stakeholders. Many PICs, including those delivering local regeneration projects, come under this category.

If services are to be successfully devolved, then some formal legal separation and devolved political responsibility are both likely to be essential preconditions. Arguably one of the reasons why the NHS Trusts failed to live up to their promised independence was that they never made a formal break from centralised government ownership, and government ministers continued to retain political responsibility. If Ministers know they will take the blame when things go wrong they will want to maintain a managerial influence. PICs need to devolve clear political accountability in addition to management authority if they are to be a useful tool in developing ‘the new localism’.

4. Local accountability

Devolution in public services is possible not only to managers, but also to the wider public. Some have seen this as the main benefit of Public Interest Companies, and have called for a ‘mutual state’ where all services are accountable to local communities through the stakeholder governance possible in the PIC format.

ippr is more cautious about the accountability potential of PICs. Whilst there are benefits to be gained from greater public involvement in some instances, there are substantial difficulties in achieving effective corporate governance of PICs.

Potential problems of PIC governance

The potential problems of corporate governance in Public Interest Companies stem from the fact that the owners of a Public Interest Company – the members – will have no significant financial interest in the business. Indeed, in the case of Companies Limited by Guarantee, members are forbidden from benefiting financially. In contrast, one of the great benefits of the shareholder model is that profit is a single unifying objective of all the owners of the business. Management is always clear what the owners want from the business.

In Public Interest Companies it is possible there will be no single overriding objective shared amongst members, particularly if members consist of a range of stakeholders taken from outside the organisation. Whilst in some industries (such as air traffic control) all the stakeholders may share similar aims, in some industries (such as rail) hostile industrial relations and ideological issues may ensure that stakeholders rarely share a common view.

Opponents of PICs have pejoratively termed these stakeholder memberships ‘rainbow coalitions’, with some justification. Stakeholder governance can be a headache for managers who might receive conflicting signals about what their priorities should be. If private lenders are allowed to borrow to PICs, they can also be suspicious of the ability of the board to take tough financial decisions, which in turn could jeopardise their funds.

Public Involvement

There are certainly advantages in making public services more open. Secrecy or opaqueness in public services can too often disguise waste and poor quality. Enabling a direct flow of information from the management of the service to the public or service users is a way to keep public managers alert to their responsibilities.

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2 The Mutual State: How Local Communities can run Public Services, New Economics Foundation, 2001
Giving service users a direct role in governance is also an effective way to ensure that users views about the service are really taken into account by management. State institutions too often presume they are operating in the interests of users by virtue that they are publicly owned. Being forced to listen to the views of users is potentially helpful. Likewise, private contractors delivering contracts to local or central government can be guided by the contract alone, and neglect communication direct with users. Again, the Public Interest Companies can be an effective way of bringing stakeholders in to the decision making process.

For many Public Interest Companies, particularly smaller-scale regeneration organisations, the primary aim of the organisation will be to increase trust and social capital in order to provide deprived communities with better skills and increased social cohesion. The corporate efficiency of such organisations is arguably a lower priority. The stakeholder membership possible in PICs is an ideal way to structure such companies. More difficult issues surrounding the quality of governance or matters of finance are much less of an issue to these smaller organisations.

One potential source of difficulty with stakeholder governance is that when considering stakeholder involvement in a PIC we are frequently talking about corporate governance, not involvement in day to day management. Yet many PICs are publicised as giving the public control over the management of the organisation. Proper corporate governance might only consist of arms-length involvement; for example shareholders who provide corporate governance in typical companies often meet only annually to appoint the board, auditors and to comment on major strategic decisions. Public accountability and trust might actually be worsened if PICs are promoted as interactive organisations, yet the public is only required to attend one meeting a year and comment on auditing matters.

There is also a key issue about who is chosen to be a public member, and whether they are suitable and representative. The few PIC-like institutions in existence already struggle to attract public members; the Housing Corporation is currently having to consider providing remuneration for board members for the first time. And where volunteers can be found, they are often the ‘great and the good’; the same faces involved representing public views across many different types of organisations such as schools, housing associations and charities. This raises an important point about the representativeness of any public members. The ‘great and the good’ are invariably middle class, self-selecting and able to subsidise any voluntary work from higher incomes. Priorities may well differ between classes, say between providing user choice for middle income groups or providing a high quality of service to the very poorest. It might also lead to good governance in wealthy areas, and very poor governance in the poorer areas; indeed ippr’s recent publication on school governance concluded that governing bodies were least effective where they were most needed³.

Although a public service crisis or major event such as the building of a new facility can drum up community interest and help provide a good range of people in the initial period, there are questions as to whether this level of interest can be sustained in the long term. The continual involvement of a parent with a child’s school might help promote long-term interest, but the infrequent relationship that most of the community has with a local hospital is less likely to engender an enthusiastic response over a long period of time; particularly if the hospital is managed well and not subject to critical local media attention. Whilst the interest of the general public in helping maintain the quality of their local institutions should not be underestimated, there is a real doubt there is a sufficient

³ ‘Parent’s Exist OK?’, ippr, 2000, p92
pool of eager and suitable members of the public to provide capacity for a large expansion in Public Interest Companies.

There is also a danger public governors could be captured by special interest groups. A real danger of the Foundation Hospital proposal is that, rather than representing the views of the wider community, the paternal relationship between hospital consultant and patient will result in public members becoming the ‘doctor’s champions’. When dealing with such emotive life and death matters it will be a brave public member who challenges consultants about extra investment in particular services, even if the public member suspects the major advantage might be to that consultant’s reputation rather than the local communities health needs.

Stakeholder governance is often regarded as a good way to deliver more responsive services. As set out above there are clear instances where this is both possible and even probable. However, there are other ways to make services more responsive besides more inclusive governance, even when delivered by PICs. For example, tenant meetings in housing associations have a mixed reputation and are frequently poorly attended, which can affect their representativeness. Some Housing Associations are turning towards alternative methods to increase tenant responsiveness and satisfaction, such as user satisfaction surveys, focus groups and more direct user interaction.

User participation can be a useful tool in improving public services. For local regeneration projects and other instances where direct participation in governance is the key policy aim, Public Interest Companies can provide a suitable vehicle for providing this inclusion. However, stakeholder governance comes with its problems, and may not even be the most effective route to more responsive services.

Unfortunately, public involvement in PIC governance whilst attractive is not simple, or without its difficulties. As such it is problematic to start justifying PICs solely on the basis of improved accountability. PICs need to also demonstrate some practical policy advantage before they should be considered for any major, complex public service.

5. What PICs don’t do

There are some assumptions about the potential benefits of Public Interest Companies which are based on misconceptions.

Choice

Contestability may be promoted by a degree of direct consumer choice in public services. For example, in the NHS patients will soon be able to choose where they will receive routine elective surgery, and this will help improve the incentives for hospitals providing these services to improve quality and capacity.

However, as noted by the Chancellor of the Exchequer in a recent speech, the scope for choice in public services is very different from most competitive product markets⁴. The consumer is not sovereign and cannot plan emergency health care consumption in the same way as weekly food consumption. Moreover choice made by some service users can impose external costs and benefits for other service users, for example if parents exercise their choice of school in ways that lead to undesirable segregation.

PICs can provide for greater contestability and diversity in key public services, but they will not provide an answer to the difficult question as to how government should balance greater consumer choice with equitable and efficient public services.

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⁴ in a speech to the SMF at the Cass Business School, 3rd February, 2003
**Off balance sheet justifications**
When supported by taxation, the off-balance sheet arguments in favour of Public Interest Companies are entirely illusory, as they are with the Private Finance Initiative and other types of Public Private Partnerships\(^5\). The logic of the argument is that if Public Interest Companies are accounted for as private companies and do not appear on the Government’s balance sheet, then they can borrow freely from the private finance markets as this borrowing will not count towards departmental expenditure limits. As a result, government departments can invest in alternative schemes, increasing the overall level of investment.

This argument is wrong. Although the *financing* for this investment comes via the private sector, in most Public Interest Companies all the *funding* comes from taxpayer via the Government. It remains a public liability; there can be no ‘extra’ investment. Government should focus on questions such as whether these bodies provide more appropriate management structures and whether they are more likely to improve services to the public. Only when the optimal solution has been reached should the Government consider how the organisation should be accounted for.

**Risk must be dealt with**
As risk bearing capital, equity plays a vital role as a financial buffer in typical companies. Public Interest Companies that do not have shareholders must replicate this flexibility if they are to be successful and stable organisations. ippr has identified six ways in which risk can be dealt with in the absence of equity.

- Debt issuers could bear the risks
- Sufficient cash reserves could be built up over the short term to absorb expected future risks
- Financial support could be obtained from Government as a substitute for risk capital
- Risks could be transferred on to the users of the service
- Risks could be absorbed within the operational performance of the company
- Risks could be externalised, through outsourced contracts or insurance

Few of these alternative methods of dealing with risk are as satisfactory as equity. As a result Public Interest Companies are probably more suitable to low risk situations and to circumstances where a combination of these different methods can be employed.

**Most PICs cannot go bust**
Having the freedom to fail is one of the principles behind private companies. The fear of failure supposedly keeps companies lean and in theory ensures that only efficient companies survive.

However, a common criticism of PPPs generally and Public Interest Companies specifically is that they cannot be allowed to go bust because they deliver an essential public service.

The principle of contestability can provide solutions to what should happen if PPPs, including PICs, get into financial or performance difficulty. Contestability is a way of keeping public services accountable by demonstrating that where service providers are failing an alternative provider can be brought in to manage the service. Public Interest Companies will be more successful if it is made clear that they will be allowed to fail, and if they do alternative management will be brought in. This will not always be easy for the Government; it risks both financial and political problems. However, if an

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organisation is propped up by state subsidy and intervention it is unlikely to gain the benefits from being and independent ‘private’ sector operator. Appropriate regulation will be key to ensure the success of uninterrupted PIC-delivered services.

**Political advantage**
The fierce debate surrounding public private partnerships has not been easy for Government. There is an understandable desire in some quarters to dilute this opposition, particularly in Scotland where the hostility to the PFI in particular has been significant. Because Public Interest Companies are not reliant on shareholders and, as such, have been described as ‘not for profits’, the PIC format can hold attractions for those simply wanting a political solution to the PPP debate. Indeed, in Argyle and Bute Council in the Scottish highlands a schools PFI is being organised as a Public Interest Company for essentially this reason.

But just how ‘not for profit’ are such schemes? Profits will still be made in these new PFIs, as it is even in traditional procurement options where the private sector is involved. Rather than profits being distributed direct from the special purpose vehicle, the contractors will receive their profits one step along the process via subcontracts. Such a solution may appear more acceptable in areas where the typical PFI has been slow to take off. However, having been sold to a community as ‘not for profit’, there may be even greater public hostility if it is revealed that in fact companies will retain the same service delivery responsibilities and will make the same – or potentially even more – money out of the public sector.

Unlike contracting for complex face-to-face public services, there is little conceptual problem with using a contract to specify an infrastructure project. Government should be wary about favouring PICs for any perceived political advantage, especially where existing and better-suited contracting models are already in use.

**6. Conclusion**

If the Government is serious about public service reform its needs to have at its disposal the fullest range of organisational forms possible. Hybrid forms such as Public Interest Companies need to be part of the Governments public sector tool kit to provide diversity and contestability for the key public services.

Public Interest Companies certainly resonate with the Prime Minister’s four principles of public service reform. They could help provide:

- contestability for the delivery of key public services
- clarity over management responsibilities and flexibility over how services are managed
- accountability and devolution of governance to local communities

However, PICs are complex organisations and should only be used in particular situations. ippr has identified two areas of mainstream public services where PICs have a role to play:

- for local regeneration schemes where increasing social capital is the key policy aim
- when contracting for complex key public services

There are two other areas where they might be applied, but these only relate to the public enterprises such as utilities and are not addressed in this paper. That is:

- where monopoly public enterprises are dependent on heavy government subsidy
where users of a monopoly essential service can become effective governors of the business

Government needs to be aware of the considerable complexities that come from PICs being private companies which are not reliant on shareholders, particularly in relation to the effect this can have on corporate governance. Also, if PICS are to be given access to private finance markets there can be serious implications in being a 100 per cent debt financed organisation. Government should perhaps address these difficult issues rather than spend legislative time pursuing what is a largely unnecessary new legal format for PICs such as the proposed Community Interest Company. To be effective PICs must be used with caution. Their potential will be seriously undermined if they are used in circumstances that are inappropriate, or where they are only presumed to bring purely political advantages.

There are many alternative organisational structures for delivering public services besides PICs, and the potential advantages of PICs are not restricted to PICs. For example alternative forms such as joint ventures between the public and private sectors might alleviate concerns about relying on contracts alone to protect the public interest when contracting for complex public services. They might also have more robust governance and risk-bearing mechanisms courtesy of their shareholders.

In some circumstances Public Interest Companies do offer advantages, and Government should give serious consideration to their use. But many of the advantages of PICs, such as greater efficiency or better clarity over management responsibilities will only be apparent to Government. It is questionable whether the general public will notice any great or immediate advantage from PICs, besides the local governance of public institutions which is fraught with potential difficulties. PICs may help retain what is often a fragile trust in public institutions, but they are certainly no magic bullet to satisfy the ever increasing demands made of our public services.